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DEPARTMENT OF STATE
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MEMORANDUM FOR MR. WALT W. ROSTOW
THE WHITE HOUSE

Subject: Civil Aviation Negotiations with Italy

The United States and Italian Governments will shortly enter into discussions to negotiate a new air transport services agreement. The new agreement is to replace the Air Transport Services Agreement concluded between the two Governments on February 6, 1948, which was denounced by the Italian Government on June 1, 1966, and, therefore, in accordance with its terms, will expire on June 1, 1967.

The enclosed memorandum describing the background and principal issues for these negotiations is transmitted for the information of Mr. Francis Bator.

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MEMORANDUM

Civil Aviation Negotiations with Italy

1. Background

(a) Historical context

Italy's denunciation on June 1, 1966 of the Air Transport Services Agreement with the United States was foreshadowed by Italy's longstanding dissatisfaction with the Agreement and by declarations made earlier on a number of different occasions that if Italy's civil aviation objectives and desires could not be met through consultations, it might be compelled to denounce. In Italy's view the present Agreement, which was concluded in 1948, is unfavorable to Italy in two respects: It permits American airlines to augment their services at will without according Italy an effective way to protect itself against excessive capacity increases. It gives to the United States very valuable routes to and beyond Italy and does not accord Italy equivalert route concessions in terms of structure or potential. After a long series of bilateral consultations and Italian representations proved unsuccessful in changing the United States position, and when the United States designated a third American carrier (Seaboard World Airlines) to initiate services into Italy, the Italian Government overcame its political reluctance to denounce the Agreement.

The United States Government has been willing in past consultations to grant new air routes to Italy which would have substantially improved Italy's route opportunities, but has not been in a position to meet Italy's specific route demands nor to accept Italian proposals for capacity controls.

(b) Importance of Italian Agreement

Italy is a major country in international air transport. It is one of the principal points of destination and transit for international travelers, especially American travelers. In each of the last five years expenditures for foreign travel of United States residents have been greater in Italy than in any other country, except Canada and Mexico. It is in a key geographical position, whose value as a gateway into Europe and as a transit point to areas beyond Europe will continue to grow with the introduction of faster

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and larger aircraft. For United States airlines, Rome is already the second most important gateway into Europe and the most important transit point in Europe for destinations beyond Europe. Italy also plays a major role in world commercial aviation through the services of its national carrier, Alitalia. Italy is therefore in a position to offer unique air transport opportunities to the United States.

Italy is also a country of considerable economic and political importance. The United States and Italy are major trading partners and have traditionally enjoyed strong cultural, ethnic and religious ties. United States international policies and programs have benefited substantially from Italy's dependable and valuable support. These economic and political considerations affirm the conclusion derived from aviation considerations that a productive, mutually beneficial and viable air transport agreement with Italy is of great concern to the United States.

2. Principal Issues

The principal issues to be resolved in the civil aviation negotiations with Italy will be (a) the question of how capacity is to be dealt with, and (b) the routes to be exchanged. There are a number of other issues which will need to be negotiated, such as the text of the new agreement, how all-cargo services are to be treated, and the right to designate a multiple number of carriers. These issues, however, are not as crucial as the problems of capacity and routes.

3. The Capacity Issue

(a) Air transport relations between Italy and the United States in the postwar period have been based upon the Bermuda principles. From the point of view of American carrier interests in Italy and of United States aviation relations with third countries, it is highly desirable that an air agreement with Italy continue to be governed by the Bermuda concepts. Consequently, we believe that as a primary objective every effort should be made to ensure that the new agreement with Italy not incorporate any significant or unnecessary deviation from liberal Bermuda principles.

(b) Although Italian officials have not claimed that the Bermuda concepts have injured Alitalia nor inhibited its growth, during the

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past six years Italian delegations have expressed increasing fear that the Bermuda provision for ex post facto reviews would not provide adequate safeguards against excessive capacity increases. In past consultations, Italian aviation authorities have indicated a willingness to accept Bermuda arrangements if a means could be established to guarantee the efficacy of capacity consultations. There are a number of possible approaches to this need that do not incorporate the objectionable features of arbitrary predetermination that the United States Government may wish to consider. As an illustration of what might be proposed, and without excluding other alternative solutions that could be explored, it may be noted that a provision, which has already been considered acceptable in principle by the United States in other bilateral negotiations, and which does not disturb basic Bermuda understandings, is a recognition that, if the two governments fail to reach agreement in a capacity consultation, either one may take protective measures if it considers that the interests of its carrier or carriers are being unduly affected. This explicit recognition would be accompanied by the provision that, in such an event, the other government may request consultations with respect to compensatory arrangements, or may take compensatory measures. This device has not been formally proposed to Italy before and has not been considered in previous consultations with Italy.

It may prove necessary to offer this, or some alternative proposal, to meet Italy's argument that a capacity consultation could conceivably end in a lack of agreement and a lack of capacity safeguards. Moreover, there is a possibility that a willingness on the part of the United States to offer some such accommodation to satisfy Italy's capacity fears may make it possible to reduce the route concessions that may have to be made to conclude an overall agreement.

4. Routes

(a) United States Routes

(i) The United States has enjoyed under the 1948 Agreement with Italy, as amended, a broadly worded route schedule, which reads: "The United States of America to Milan, Turin, Rome, Naples and beyond." The United States Government has interpreted this route grant to permit air services to Italy via intermediate points in Canada, Western Europe and North Africa, and beyond Italy to points in the Eastern Mediterranean, the Near and Middle East, and the Far East. Although American carriers have not exercised the right to serve Turin and Naples, they have established a number of routings to and through Rome and Milan, which have proved highly useful and profitable. It is expected that our

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primary route objective in the Italian negotiations will be to obtain continuation of the rights which United States carriers have operated and have claimed under the existing route schedule.

(ii) In addition, in the past the United States has given consideration to the desirability of obtaining a route beyond Italy to points in East Africa and beyond to South Africa. This desire has been indicated to Italy in the past but has not been pressed. Although it does not appear that American carriers would be able to operate such a route immediately, the renegotiation of the Italian agreement presents an opportune time to obtain the right to such a route for future purposes. A secondary route objective for the United States could, therefore, be a route beyond Italy to East and South Africa.

(b) Italian Routes

The present route schedule between the United States and Italy grants to Italy a route from Italy via intermediate points to Boston and New York, and beyond, and a second route from Italy via intermediate points to Chicago. A footnote in the Italian schedule states that the rights beyond New York shall be exercised to points in other countries "to be determined later." On the basis of past consultations, it is expected that Italy's route demands in the forthcoming negotiations will include (1) a reaffirmation of its present routes to Boston, New York and Chicago, (2) a new route to Los Angeles, (3) the extension of its route to New York beyond New York to Mexico City, and (4) the right eventually to operate a route across the Pacific beyond either Los Angeles or Mexico City, or both. In addition, Italy may need to request a restructuring of its routes to United States points; because of a Canadian restriction on the use of Montreal by Alitalia as an intermediate point, Alitalia would not be able to serve both Los Angeles and Chicago via Montreal. Therefore, Italy may propose routing changes to the United States cities that it already serves.

The motives underlying Italy's route demands appear to be (1) to obtain new routes that will permit Alitalia to grow and to maintain a competitive position among the major world airlines, (2) to achieve a greater symmetry or equality between United States and Italian routes under the bilateral, and (3) to establish a greater equality between Italy's routes under the bilateral and the routes the United States has granted to other countries of a similar size and importance as Italy. To meet these objectives, Italy has expressed its desire to have the right to operate air services beyond the United States, and eventually, if not immediately, to operate a round-the-world route.

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(i) The United States in 1960 agreed to grant Italy a route to Los Angeles if other elements of an air transport agreement could be resolved. These other elements have not been resolved, but the Los Angeles route has been included in every route proposal considered between the two countries during the past five years. It is to be expected that the Italian request for this route would be granted within an overall agreement.

(ii) In the August 4, 1960 exchange of notes amending the bilateral route schedule, Italy was granted a route to New York and beyond "to points in other countries to be determined later." Italy has made strong and repeated efforts in past consultations to obtain US agreement on a route beyond New York to Mexico City on the basis of the 1960 provision.

Alternative suggestions of routes beyond New York or beyond the United States have not been acceptable or feasible, and this issue has become a principal stumbling block to agreement between the two countries. There is considerable likelihood that this route might need to rely predominantly, at least for a long initial period, on secondary justification traffic, i.e., local New York/Mexico City traffic. It is also quite possible that without the grant of this route it will not be possible to conclude an agreement with Italy that will retain for US carriers the routes that they now enjoy beyond Italy.

The United States has granted beyond-US rights to 16 countries in bilateral agreements; some of these countries enjoy several routes beyond the United States. Italy's aviation, economic and political importance is well above the average of those 16 countries and it is difficult to conceive that those 16 countries could provide better traffic justification for their routes beyond the United States than Italy could. The New York-Mexico City route would put the United States-Italian route exchange in closer equilibrium, and would bring the Italian route grant closer into line with the route grants given by the United States to third countries. These reasons support the view that the United States should be prepared to grant Italy a route beyond New York to Mexico City.

(iii) As indicated above, Italy will very probably press strongly in the negotiations for a round-the-world route across the Pacific beyond Mexico City or Los Angeles, or both. Italy undoubtedly feels that Alitalia will need to obtain a round-the-world route to

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maintain a competitive position in world commercial aviation. Italy may also feel that, if the United States is to be given routes beyond Italy which permit round-the-world routings, it would be equitable for Italy to obtain a round-the-world opportunity in exchange. It is feared that such a route would divert substantial traffic from US carriers and would depend substantially upon non-Italian traffic. In addition, it is possible that the grant of a round-the-world route to Italy would be followed by requests for similar rights from other foreign countries. These arguments conclude that Italy's request for a route around the world should be resisted. However, such a route, perhaps on a deferred basis, may be essential to conclusion of an agreement. In view of the great value of such a route, it is expected that it would be given serious consideration only within the context of an agreement which fully meets US route desires, which incorporates a reaffirmation of Bermuda capacity principles, and which satisfactorily resolves the subsidiary issues of all-cargo services and multiple designation rights.

(c) Commercial Value of Routes

Since a route grant is essentially a commercial franchise, the objective of the United States in aviation negotiations is, in general, to bring about route exchanges that are roughly equivalent in commercial value and to avoid exchanges that are commercially unfavorable to the United States. The CAB staff study on Italy has developed some estimates, based on 1965 data of the origin and destination of passengers, which indicates that United States carriers have had access to about $70 million in passenger revenues while the Italians have had access to $53 million. This represents a favorable dollar margin for US carriers of about $17 million on the basis of the present route structure for the United States and Italy. The staff study estimates an annual value of $3 to $4 million to the route Italy via Montreal to Los Angeles and another $3 to $4 million to the Mexico City rights beyond New York. A route for Italy beyond Los Angeles to the Orient is given a value of from $4.6 million to $9.5 million depending in part on whether it is routed via the North Pacific or via Honolulu. These are, of course, merely estimates. Although the use of other statistical approaches or criteria could lead to different estimates, the above data give an average range and present a measure for judging the economic equilibrium of the routes being considered.

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5. United States Views

The preliminary session with Italy which will take place in January will undoubtedly give the United States a clearer idea of Italian desires and priorities in the forthcoming negotiations. Until Italy's objectives are known more definitively, it is difficult and perhaps unnecessary to arrive at a firm United States position. In the meantime, however, this Department and the Civil Aeronautics Board have been exchanging preliminary views, and are seeking to obtain the views of United States airlines on the issues expected to arise in the Italian negotiations.

In general, the American airline industry recognizes the importance of having a mutually acceptable air transport agreement with Italy. The three airlines which now operate scheduled services to Italy - PAA, TWA and Seaboard World Airlines - uniformly advocate a hard line on the negotiations, particularly with respect to the capacity issue. United States carriers recognize the need to give Italy a more valuable route offer than has been offered to it in the past in order to be able to conclude a new agreement. PAA, TWA and Seaboard have expressed support for the grant to Italy of a new route to Los Angeles and a route beyond New York to Mexico City. Eastern Air Lines, which in the past strongly opposed the grant of a New York-Mexico City route to Italy, has confirmed its continuing opposition to the Mexico City extension. TWA has communicated the view that there should be a reciprocal exchange of round-the-world rights between the United States and Italy, and considers as equally important that rights beyond Italy to East and South Africa be secured. PAA, on the other hand, believes that the United States should confine its route objectives to obtaining from Italy authority for United States flag services as presently certificated by the CAB (this would include round-the-world routings for the United States but would exclude the East and South Africa routes), but stated that it would prefer to see the Agreement expire rather than grant beyond-Los Angeles rights to Italy.

As negotiations with Italy develop further industry views will be added to these preliminary ones, and it is to be expected that any route package would be opposed by some part of the industry. However, the importance of United States airline interests in Italy and the value of obtaining a reaffirmation of liberal capacity principles in our air relations with Italy would make a substantial and valuable route offer to Italy fair and appropriate.

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